



## Client Update | Tax

### A New Tax Treaty between Israel and Australia

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April 4, 2019

Dear Clients and Friends,

**On March 28, 2019, Israel and Australia signed their first ever tax treaty (the "Treaty").**

The purpose of the Treaty is to eliminate double taxation with respect to taxes on income, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

Amongst other benefits, the Treaty gives greater certainty to Israeli and Australian individuals and companies alike, who may be working in the other country or have business operations there, as to how to resolve conflicts and inconsistencies between Israeli and Australian rules on important matters including tax residency and taxable presence (permanent establishment).

The main issues covered by the Treaty are as follows:

▶ **Residency of individuals, corporations and trusts**

Under the Treaty, the term "resident of a Contracting State" means, in general, any person who, under the laws of that State, is liable to tax as a resident of such State.

**Tie breaker rules for entities.** Where a company or partnership would be resident in both countries under domestic rules, the residency of the entity will be determined according to Mutual Agreement Procedures between the Israeli and Australian tax authorities, having regard to the entity's place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such entity shall not be considered a resident of either Contracting State in order to enjoy benefits under the Treaty.

**Trusts.** It is not entirely clear how the Treaty will affect the taxation of trusts. However, it appears that the taxation of trusts that are both Israeli and Australian tax resident will be determined by way of Competent Authority Procedures. Accordingly, trusts that are resident both in Israel and Australia under domestic rules should obtain specific advice.

► **Dividends:**

This provision is primarily for the benefit of Australian investors in Israeli companies, since Australia generally does not impose withholding tax on “fully franked” dividends under its domestic law, whereas Israel imposes 30% withholding tax on dividends in most cases.

Where the recipient of the dividend is a company, the withholding rate will be limited to 5%, provided that the shareholding company holds at least 10% of the rights in the company distributing the dividend. In all other cases, the withholding tax rate will be limited to 15%.

Australian investors in Israeli REITs (which are transparent structures for Israeli tax purposes) will receive a substantial benefit under the Treaty, in that the Israeli tax will be limited to 15%, rather than 25% or even, in some circumstances, up to 50% Israeli tax in the absence of the Treaty benefit.

In addition, pension funds and certain governmental investors holding less than 10% of a company will be exempt from withholding tax under the Treaty.

- **Interest:** The Treaty limits the withholding tax rate on interest to 10%, and to 5% when the interest is paid to certain financial institutions and pension funds.
- **Royalties:** This Treaty provision gives a substantial benefit to Israeli technology companies looking to license their intellectual property to Australian customers.

Without the benefit of the Treaty, under Australian domestic law, 30% withholding tax on the gross amount of the royalty would apply, which is substantially higher than the 23% corporate tax rate generally applicable to the Israeli licensor on its net income (and there is an even bigger gap where the Israeli company is entitled to special Israeli tax benefits for technology companies), meaning that even with the benefit of the Israeli credit for foreign taxes paid, the Israeli company would be out of pocket.

Under the Treaty, withholding tax imposed by either country is limited to 5% of the gross amount of the royalty.

## General Issues

A Mutual Agreement Procedure is established between the competent authorities of the two countries, in order to resolve conflicts which are not otherwise resolved under the Treaty rules. However, the Treaty does not provide for a binding arbitration mechanism.

A framework is also established with regard to the sharing of sensitive information regarding tax matters between the two countries, and standard provisions are applied to prevent tax discrimination against nationals of the other country.

Importantly, an anti-treaty shopping provision (“principal purpose test”), and other provisions compliant with the OECD’s Base Erosion and Profit Shifting (BEPS) project aimed at preventing tax avoidance and double non-taxation, have been included.

In this manner, the risk of double taxation, always a concern of businesses operating internationally, is substantially mitigated.

The Treaty will enter into force following its ratification by both countries.

If you would like to further explore the opportunities for Israeli-Australian cooperation created by the new Treaty, we would be happy to discuss it with you in further detail.

Sincerely,

**Herzog Fox & Neeman**

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